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IN THE

Supreme Court of the United States

October Term, 1973

No.....

ROSE ANN COATES TRUST, ROBERT N. COATES, Trustee; Trust Under Will of SYDNEY N. COATES, ROBERT N. COATES, Trustee; PETER M. COATES; CHARLES N. COATES; PAMELA L. COATES; CATHY A. COATES,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

Petitioners pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Ninth Circuit entered on June 5, 1973.

OPINIONS BELOW

The opinion of the court of appeals (App. A, *infra*, pp. A-1 to A-8) is not yet reported. The opinion of the United States Tax Court (App. B, *infra*, pp. A-9 to A-27) is reported at 55 T.C. 501.

JURISDICTION

The jurisdiction of this Court is invoked under 28 U.S.C. §1254(1).

QUESTIONS PRESENTED

Whether Section 304 or Section 351 of the Internal Revenue Code of 1954 prevails in a transaction where both sections are applicable.

STATUTES INVOLVED

The pertinent provisions of Sections 301, 302, 304, and 351 of the Internal Revenue Code of 1954 are set forth in Appendix C, *infra*, pp. A-28 to A-31.

STATEMENT OF THE CASE

In 1948, Sydney Coates incorporated his sole proprietorship as Coates Electric Manufacturing Company; the name of this corporation was subsequently changed to CAM Industries, Inc. CAM manufactured a line of commercial and industrial electrical equipment.

Sydney Coates, together with his son, Robert Coates, and Sydney Coates' two sons-in-law, Arthur Heinen and Morgan Boyd, incorporated Washington Industrial Products, Inc. (hereinafter called "WIP") to take over the assets and contracts of a corporation in the related business of manufacturing ovens for the food industry. The incorporators of WIP each received one-fourth of the corporation's capital stock.

CAM and WIP operated as separate corporate entities until 1965. Robert N. Coates managed CAM and succeeded his father as president in 1963. Although Robert Coates was generally familiar with the operations of WIP, the company was managed by Arthur Heinen from 1955 until 1965. In 1965, the management of WIP and CAM, having determined that substantial economies could be realized by combining the personnel, inventories, purchasing and

machinery of both corporations, decided to combine WIP and CAM.

Before his death in 1963, Sydney Coates gave most of the CAM stock he owned to members of his family. Robert Coates received control of over two-thirds of the voting stock and 51% of the total stock of CAM. In combining CAM and WIP, Robert Coates required that he have the same ownership interest in the resulting entity as he had in CAM. Since a reorganization under Section 368 was not feasible, the shareholders of WIP, on May 20, 1965, exchanged their shares in WIP for agreements from CAM to pay $1,000 per share of stock over a ten-year period with interest thereon. (App. A, pp. A-2 to A-3).

In his deficiency notices, the Commissioner of Internal Revenue treated the transactions as a redemption by a related corporation under Section 304(a)(1) taxable as a dividend at the face value of the agreements. The United States Tax Court sustained the Commissioner's position with the exception that the fair market value of the agreements was determined to be 60% of their face value and the court of appeals affirmed.

REASONS FOR GRANTING THE WRIT

I. The court below erroneously decided an important question involving the application of two sections of the Internal Revenue Code providing for radically different tax treatment of the same transaction. The decision of the court below is directly in conflict with the decision of the Court of Appeals for the Sixth Circuit in *Commissioner v. Stickney*, 399 F.2d 828 (1968), *aff'g sub nom., Henry McK. Haserot*, 46 T.C. 864 (1966). The existence of this direct conflict was noted by the Ninth Circuit in its opinion in

Appendix A, *infra*, p. A-6. The Ninth Circuit based its decision on the separate opinion of Judge Tannenwald of the United States Tax Court in *Henry McK. Haserot*, 46 T.C. 864, a decision of the full Tax Court.

The question is one of statutory interpretation and has previously been decided in only one reported case, *i.e.*, *Commisioner v. Stickney, supra*. Since the decision in *Stickney* is the result of years of litigation requiring four separate opinions before final resolution, it may be helpful to clarify the history of the case.

The taxpayer, Henry McK. Haserot, controlled three corporations, Northport Cherry Factory, Inc., Gypsum Canning Co. and Haserot Co. Haserot Co. purchased the entire production of Northport and Gypsum and furnished the management and financing for those corporations. In February 1958, the taxpayer, having decided to place Northport and Gypsum under the direct control of Haserot Co., transferred to Haserot Co. his shareholdings in these corporations in exchange for $64,850 in cash and 2,432 shares of Haserot Co. A deficiency was determined by the Commissioner after the taxpayer failed to report income from this transaction. The only issue before the Tax Court was whether the cash received by the taxpayer was taxable at capital gains rates as Section 351(b) "boot" or as dividend income under Section 301(c)(1) by virtue of Sections 304(a)(1) and 302(d). Since Section 304 is not self-executing, dividend treatment results only if both Section 302(d) and Section 301(c)(1) are also applicable.

In *Henry McK. Haserot*, 41 T.C. 562 (1964), *remanded*, 355 F.2d 200 (6th Cir. 1965), the Tax Court held that Section 351 prevailed over Section 304 on the ground that the

"Except as otherwise provided" limitations of Sections 301(a) and 302(d) indicated that Section 301 dividend treatment can result only if no other provision in chapter 1 and subchapter C, respectively, requires other treatment.

The Sixth Circuit remanded the first *Haserot* decision for findings on the issue of dividend equivalency without deciding whether Section 304 or Section 351 took precedence in the transaction. In the second *Haserot* decision the majority of the Tax Court limited its decision to a finding that the distribution of cash to the taxpayer by Haserot Co. was essentially equivalent to a dividend within Section 302(b)(1). Judge Tannenwald, however, in a separate opinion in which Judge Simpson concurred, expressed the opinion that Section 304 should take precedence over Section 351 where a transaction comes within the literal language of both sections. On appeal, the Sixth Circuit affirmed the first Tax Court decision in *Haserot* that Section 351 takes precedence over Section 304 thus rejecting Judge Tannenwald's reasoning.

As for the merits, little can be added to the above referenced opinions which delineate the difficult question of statutory interpretation presented herein. Ultimate resolution of this issue will depend primarily on the interpretation accorded the "Except as otherwise provided" limitations in Sections 301(a) and 302(d). The Sixth Circuit found the only reasonable explanation of the limiting clause in Section 301(a) was that, when another section of the chapter has application, the Section 301 treatment is to be excluded. Petitioners submit the *Stickney* decision, which gives effect to the limiting clauses of Sections 301(a) and

302(d), is correct. This question of statutory interpretation, having created a clear conflict in the circuit courts, can only be resolved by this Court.

II. Resolution of the question presented is necessary to provide for certainty in transactions by shareholders of related corporations. The present conflict of decisions magnifies the problems and uncertainties faced by shareholders of related corporations who seek to restructure their ownership interests in such corporations. As stated in the findings of fact set forth in the decision of the United States Tax Court in the instant case, the purpose of the transaction in question was to combine two family owned corporations which, because of the requirements of the majority shareholder of CAM Industries, Inc., could not be accomplished by a reorganization under Section 368.

The transaction adopted to effect this combination, assuming the legal consequences were determined in accordance with the *Stickney* decision, would have resulted in no adverse tax consequences to the petitioners. This transaction, essentially a transfer of WIP shares for long-term installment obligations of CAM which the Ninth Circuit assumed for purposes of argument to be "securities", would have been governed by the provisions of Section 351. Since no "boot" *i.e.*, cash or other property, was received in this transaction, the owners of shares in WIP would have carried over their basis in such shares to the installment obligations without immediate tax consequences.

Notwithstanding the decisions of the Tax Court in both *Haserot* cases and the affirming opinion of the Sixth Circuit, holding that Section 351 takes precedence over Section 304, the court below reached a contrary conclusion.

Rather than considering the transaction to be within the non-recognition provision of Section 351, the Ninth Circuit requires that the transaction be considered a redemption under Section 304 with dividend treatment resulting by application of Sections 302(d) and 301(c)(1). The conflict created by the Ninth Circuit decision leaves the Commissioner and all taxpayers uncertain of the statute to be applied in similar transactions.

Until this Court provides a definitive solution, private counsel will, as a practical matter, be unable to advise their clients to resolve problems such as those raised here, short of litigation. Unless the Court resolves the present conflict in the circuits, taxpayers in control of related corporations in different parts of the nation will be taxed differently even though they consummate virtually identical transactions concerning their shareholdings in related corporations.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

JOSEPH H. TRETHEWEY
GERALD R. HERGERT of
TRETHEWEY & BRINK
Attorneys for Petitioners

August 1973

APPENDIX A

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

ROSE ANN. COATES TRUST, ROBERT N. COATES, TRUSTEE; TRUST UNDER WILL OF SYDNEY N. COATES, ROBERT N. COATES, TRUSTEE; PETER M. COATES; CHARLES N. COATES; PAMELA L. COATES; CATHY A. COATES, *Appellants-Petitioners,* v. COMMISSIONER OF INTERNAL REVENUE, *Appellee-Respondent.*	Nos. 71-1968 71-1969 71-1970 71-1971 71-1972 71-1973

[June 5, 1973]

Appeal from the Tax Court of the United States

Before: CHAMBERS, WRIGHT, and KILKENNY, Circuit Judges.

WRIGHT, Circuit Judge:

Sydney and Rose Ann Coates, together with their children, children's spouses, and grandchildren, owned all of the shares of two corporations, CAM Industries, Inc. (hereinafter called CAM) and Washington Industrial Products, Inc. (hereinafter called WIP). After the death of Sydney Coates, the family group agreed to combine the two corporations by having CAM "purchase" the shares of WIP.

When the transaction was complete, CAM and WIP shares were held by members of the family as follows:

	WIP	CAM Class A Voting	CAM Class B Nonvoting
Estate of Sydney Coates	75		664
Robert N. Coates	51	1,640	2,250
Peter Coates	6		205
Cathy Coates	6		205
Pamela Coates	6		205
Charles N. Coates	6		205
Marjorie Coates (Mrs. Robt.)			290
R. Morgan Boyd	63	10	422
Robert M. Boyd, Jr.	6		391
James Boyd	6		391
Ruby Boyd (Mrs. R. M.)		390	372
A. C. Heinen	57	10	375
Barbara Heinen	6		340
Gary Heinen	6		340
Richard Heinen	6		340
Molly Heinen (Mrs. A. C.)		390	325
Totals	300	2,440	7,320

The "purchase" was effected on May 20, 1965 when CAM and the shareholders of WIP entered into agreements in this form:

AGREEMENT FOR SALE OF STOCK

Agreement made this 20th day of May, 1965, by and between the undersigned "Seller" and CAM INDUSTRIES, INC., a corporation, hereinafter called the "Buyer."

Seller hereby sells to Buyer, and Buyer hereby purchases from Seller, ... shares of the common stock of Washington Industrial Products, Inc., a Washington corporation, at the price and on the terms and conditions herein set forth.

1. Purchase Price. The price to be paid by Buyer to Seller for said shares of common stock shall be $1,000.00 per share or an aggregate purchase price of .....

2. Delivery of Stock and Payment of Purchase Price.

(a) The certificate or certificates for the shares of common stock sold hereunder by Seller are herewith delivered to Buyer, duly endorsed for transfer to Buyer,

and Buyer hereby acknowledges receipt of said certificate or certificates.

(b) The purchase price shall be paid ....., or more at Buyer's option, on or before May 31, 1966, and a like sum, or more at Buyer's option, on the 31st day of May of each year thereafter until the 31st day of May, 1975, at which time the entire unpaid balance of the purchase price shall be due and payable. Buyer shall pay interest on the diminishing balance of said purchase price at the rate of four percent per annum from the 1st day of June, 1965, which interest shall be deducted from each installment payment and the balance of each payment applied in reduction of principal.

3. *Successors and Assigns. The provisions of this agreement shall inure to the benefit of and bind the successors and assigns of Buyer and the executors, administrators, heirs, successors and assigns of Seller.*

Subsequently, by order of the Superior Court of Washington for King County on September 23, 1965, Robert N. Coates as Trustee of the Trust Under Will of Sydney Coates received an undivided one-third interest in the May 20 contract for the sale of 75 shares of WIP held by the Sydney Coates Estate. By the same order Robert N. Coates as Trustee for the Rose Ann Coates Trust[1] received an undivided two-thirds interest in the May 20 contract for the sale of the 75 shares held by the Estate.[2]

1. Sydney and Rose Ann Coates had executed mutual wills. His will gave the house, auto, bank accounts and personal effects to Rose Ann Coates, with the residue of his estate going to the Trust Under Will of Sydney Coates. Her will provided that, in the event Sydney Coates predeceased her, she would convey by separate instrument her interest in any community property "to the Trustee or Trustees as named under the terms of the Trust created by the Will of Sydney N. Coates." Pursuant to this agreement, the Rose Ann Coates Trust was created by instrument dated August 21, 1965, executed by Rose Ann Coates, trustor, and Robert N. Coates, trustee.

2. The court below determined that the WIP stock was held by Sydney and Rose Ann Coates as community property. 37½ shares belonging to each spouse. The odd apportionment is explained by the Order Approving Final Account, Report and Decree of Distribution of the Superior Court, which provided that in dividing the community property "any disproportionate allocation necessary shall be made in the respective ownership of the contract receivable for the sale of the Washington Industrial Products stock."

In their 1965 income tax returns, all parties reported the 1965 transaction as a sale of their WIP stock entitling them to capital gain treatment. In his notice of deficiences the Commissioner treated the "sale" as a redemption by a related corporation under §304(a)(1) of the Internal Revenue Code of 1954,[3] taxable as a dividend at the face value ($1,000) of the agreements. The Tax Court upheld the Commissioner's §304(a)(1) and dividend treatment,[4] but found the fair market value of the agreements to be 60% of their face value rather than 100% as determined by the Commissioner. It is from this decision that the taxpayers appeal.[5]

I.

Initially, petitioners contend that since the two trusts were not in existence at the time of the transfer of the WIP shares to CAM they are not taxpayers within the meaning of §7701(a)(14), and that, accordingly, the Commissioner determined deficiencies against the wrong parties. They would have us hold that since the WIP shares were community property, the proper parties for taxation are the Estate of Sydney Coates and Rose Ann Coates. We decline to do so and affirm the Tax Court.

The Trust Under Will of Sydney Coates, under §§661 and 662, was a proper party to the proceedings below. While the question raised as to the Rose Ann Coates Trust is more difficult, we have concluded it also was a proper party below. Upon the death of her husband, Mrs. Coates held her community property interest in the WIP shares subject to a restriction on their use, by virtue of the mutual

3. All section references hereafter are to the Internal Revenue Code of 1954, as amended.

4. On October 24, 1969, the Tax Court entered decisions of no deficiency in the following listed cases on the basis that the redemption of their stock in WIP by CAM was substantially disproportionate pursuant to §302(b)(2): Arthur C. Heinen and Molly M. Heinen; Estate of Ruby M. Boyd, deceased, R. Morgan Boyd, executor; R. Morgan Boyd; Robert W. Boyd and Judith K. Boyd; Gary A. Heinen; Richard C. Heinen; Barbara Gaye Heinen; James E. Boyd. Robert and Marjorie are not parties in this case because of other matters with respect to their 1965 return which had not been resolved by the Service at the time this suit was instituted.

5. The decision of the Tax Court is reported at 55 T.C. 501 (1970).

wills (see footnote 1 *supra*). Under Washington law her agreement to transfer her half of the community property into trust was specifically enforceable by the beneficiaries thereof. *In re Young's Estate*, 40 Wash.2d 582, 244 P.2d 1165 (1952).

Thus on May 20, 1965 when the WIP shares held by the Estate were "sold," Mrs. Coates held her half of the community property in constructive trust for the beneficiaries of her agreement.[6] *Cf. Healy v. Commissioner*, 345 U.S. 278 (1953). We conclude, therefore, that the beneficial and equitable owner of the 50 WIP shares on May 20 was the Rose Ann Coates Trust, and as such it was subject to the tax on the transfer thereof. 2 Mertens, Law of Federal Income Taxation, §17.08 (1967 Revision).

II.

Petitioners next contend that the agreements entered into on May 20 between CAM and the WIP shareholders are "securities" as that term is used in §351[7] and that, since after the May 20 transaction the WIP shareholders controlled over 80% of the stock of CAM, §351 operates to grant them either no tax liability or capital gain treatment.[8] The Tax Court concluded that the agreements were not securities, citing *Warren H. Brown*, 27 T.C. 27 (1956).

Petitioners argue that the *Brown* decision creates an invalid distinction between an installment sales contract and other long term corporate obligations. *See* Bittker &

6. It is noteworthy that at no time after the death of her husband did Mrs. Coates obtain control over the WIP shares or the purchase agreements. Also, the agreements did not pass through Mrs. Coates, but rather were transferred directly from the Estate of Sydney Coates to the Rose Ann Coates Trust.

7. Section 351(a) provides that:

> No gain or loss shall be recognized if property is transferred to a corporation . . . by one or more persons in exchange for stock or securities in such corporation and immediately after the exchange such person or persons are in control . . . of the corporation.

8. The taxpayers argue two alternative positions: (1) that all of the agreements are securities, that §351 in [sic] applicable and, no "other property" having been received, that the taxpayers did not incur any tax liability on the transfer; or (2) that certain of these agreements are "securities" but that some of them could be treated as "other property" under §351, thus making the transaction taxable at capital gains rates to the extent of the value of this other property.

Eustice, Federal Income Taxation of Corporations and Shareholders 3-55 (3rd Ed. 1971); Comment, Section 351 Transfers to Controlled Corporations: The Forgotten Term—"Securities," 114 U.Pa. L. Rev. 314 (1965). We do not reach that issue, however, for even assuming *arguendo* that these agreements are "securities" under §351, we are convinced that the provisions of §351 are overridden by those of §304 and that, accordingly, §304 and not §351 applies to this transaction. *See Henry McK. Haserot*, 46 T.C. 864, 872 (1966) (Tannenwald, J.) (separate opinion).

In *Commissioner v. Stickney*, 399 F.2d 828 (6th Cir. 1968), *aff'g Henry McK. Haserot, supra*, the Sixth Circuit reached a contrary result. While the statutory language and legislative history reveal that Congress did not provide for or contemplate the possible conflict between the permissive policy of §351 and the preventive policy of §304, we are convinced that our decision "best achieves the underlying legislative intent and policy and . . . more nearly reflects the manner in which Congress would have 'straightened this ruck out if they had come across it.'" *Haserot, supra* at 878 (Tannenwald, J.). Accordingly, we decline to follow the Sixth Curcuit for the reasons so cogently set forth by Judge Tannenwald.[9]

III.

Petitioners next argue that the Tax Court erred in holding that the transaction was a redemption through the use of a related corporation under §304(a)(1). They would have us hold that the "one or more persons" of §304(a)(1)(A) refers to one person plus those persons

9. Our case reveals the ultimate inconsistency that would result if we followed *Stickney* and held that the "except as otherwise provided" provisos of §§302(d) and 301(a) precluded §304 applicability to these taxpayers. Other parties to this transaction were taxed at the capital gains rate by virtue of §§304(a) and 302(b)(2). See footnote 4, *supra*). That result would not be altered were we to follow *Stickney's* interpretation of the provisos. Thus *Stickney's* rationale would lead us to hold that those specifically excluded by Congress from dividend treatment (by virtue of §302(b)(2)) would be taxed at the capital gains rate, while those Congress intended to be taxed at ordinary income rates (by virtue of §§304(a), 302(d), and 301(a)) would escape taxation altogether by §351. Such a result does not comport with our reading of the legislative intent behind §§304 and 351.

whose shares are attributed to him under §318, and that the concept of aggregate control as prescribed by Reg. §1.304-2(b)[10] and applied by the Tax Court departs from the specific language and intent of the statute.

Petitioners misconceive the operation and effect of §304. That section was not designed to be so narrowly confined as to relate only to "family" transactions. To the contrary, it was designed to apply to any closely held corporations whether or not the parties were related by blood. The phrase "or more persons" is not superfluous, as petitioners ultimately must contend, but rather indicates an attempt to expand the scope of §304(a)(1) beyond the family relationship to include unrelated persons who act in concert. *See Radnitz v. Commissioner*, 187 F. Supp. 952 (S.D.N.Y. 1960), *aff'd* per curiam, 294 F.2d 577 (2d Cir. 1961).

Since in the instant case the same group of persons controlled both WIP and CAM, §304(a)(1) applies to this transaction, and the property received by the WIP shareholders must be treated as a distribution in redemption of the stock of CAM.[11]

IV.

To determine the tax consequences of a §304(a)(1) redemption, it is necessary to refer to §302. Unless the redemption qualifies as an exchange under one of the categories of §302(b), it is to be treated under §301.[12]

10. Reg. §1.304-2(b): In any case in which two or more persons, in the aggregate, control two corporations, section 304(a)(1) will apply to sale by such persons of stock in either corporation to the other (whether or not made simultaneously) provided the sales by each of such persons are related to each other. The determination of whether the sales are related to each other shall be dependent upon the facts and circumstances surrounding all of the sales. For this purpose, the fact that the sales may occur during a period of one or more years (such as in the case of a series of sales by persons who together control each of such corporations immediately prior to the first of such sales and immediately subsequent to the last of such sales) shall be disregarded, provided the other facts and circumstances indicate related transactions.

11. Section 304(a)(1)(B).

12. It is undisputed that §301 treatment results in the distribution being taxed to each of the taxpayers as a dividend under §§316 and 301(c)(1).

The only portion of §302(b) relevant here is §302(b)(1), which provides that a redemption shall be treated as an exchange if it is "not essentially equivalent to a dividend." To so qualify, the redemption "must result in a meaningful reduction of the shareholder's proportionate interest." *United States v. Davis*, 397 U.S. 301, 313 (1970).

The instant transaction resulted in no reduction in any of the taxpayers' proportionate interests in WIP.[13] That being the case, the Tax Court correctly concluded that the distribution did not qualify for the preferred treatment under §302(b)(1).

Taxpayers attempt to distinguish *Davis* on the grounds that that opinion applies only to 100% shareholders. The rationale of *Davis* does not support such a distinction, and we reject it without further discussion.

V.

Petitioners finally contend that the Tax Court erred in determining the fair market value[14] of the agreements to be $600 per $1,000 face value. We have carefully examined the record and conclude that there was ample support for the court's finding. It certainly was not clearly erroneous.

The decision of the Tax Court is affirmed.

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13. The relevant inquiry concerns the taxpayers' respective interests in WIP. Section 304(b)(1).

14. The amount of the distribution is the fair market value of the property received. Section 301(b)(1).

APPENDIX B

UNITED STATES TAX COURT

ROSE ANN COATES TRUST, ROBERT N. COATES, TRUSTEE, ET AL.,[1] PETITIONERS *v.* COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Docket Nos. 5810-68, 5813-68, 5834-68, 5870-68, 5872-68. Filed December 15, 1970.

The Coates family owned all of the shares of CAM corporation and WIP corporation. CAM "purchased" the shares of WIP. *Held:*

1. The Rose Ann Coates Trust, not Rose Ann Coates, was the proper taxpayer where Rose Ann Coates had agreed by mutual will to place her community shares in trust, and the transaction occurred after the death of her husband.

2. The Trust Under Will of Sydney Coates was a proper taxpayer where income from a transaction executed by the Estate of Sydney Coates was passed through to the trust-beneficiary.

3. The transaction was a redemption by a related corporation under sec. 304. Sec. 351 not applicable.

4. The redemption was essentially equivalent to a dividend. Business purpose is irrelevant. *United States v. Davis*, 397 U.S. 301 (1970).

Joseph H. Trethewey, for the petitioners.
Millard D. Lesch, for the respondent.

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1. Proceedings of the following petitioners are consolidated herewith: Trust Under Will of Sydney N. Coates, Robert N. Coates, Trustee, docket No. 5813-68; Peter M. Coates, docket No. 5834-68; Charles N. Coates, docket No. 5870-68; Pamela L. Coates, docket No. 5871-68; and Cathy A. Coates, docket No. 5872-68.

DAWSON, *Judge:* In these consolidated cases respondent determined the following deficiencies in petitioners' Federal income taxes for the year 1965:

Petitioner	*Docket No.*	*Deficiency*
Rose Ann Coates Trust, Robert N. Coates, Trustee	5810-68	$12,936.62
Trust Under Will of Sydney N. Coates, Robert N. Coates, Trustee	5813-68	5,313.41
Peter M. Coates	5834-68	654.42
Charles N. Coates	5870-68	427.00
Pamela L. Coates	5871-68	427.00
Cathy A. Coates	5872-68	602.87

By amendment to his answer, respondent has claimed the following additional deficiencies:

Petitioner	*Docket No.*	*Deficiency*
Rose Ann Coates Trust, Robert N. Coates, Trustee	5810-68	$11,495.89
Trust Under Will of Sydney N. Coates, Robert N. Coates, Trustee	5813-68	4,966.42
Peter M. Coates	5834-68	511.06
Charles N. Coates	5870-68	419.20
Pamela L. Coates	5871-68	419.20
Cathy A. Coates	5872-68	470.03

The key issues presented for decision are: (1) Whether the sale by petitioners of all of their stock in Washington Industrial Products, Inc., to CAM Industries, Inc., on May 20, 1965, was a redemption through the use of a related corporation under section 304(a)(1), I.R.C. 1954;[2] (2) whether the redemption of all of the stock in Washington Industrial Products, Inc., by CAM Industries, Inc., was essentially equivalent to a dividend to petitioners under section 302(b)(1) so that the amounts received by them are taxable as ordinary income; and (3) the fair market value of the contracts received by petitioners from CAM Industries, Inc., on May 20, 1965. There is a preliminary question as to whether the Rose Ann Coates Trust and the Trust Under Will of Sidney N. Coates are proper parties in these proceedings.

2. All statutory references are to the Internal Revenue Code of 1954, as amended, unless otherwise indicated.

FINDINGS OF FACT

Some of the facts have been stipulated. The stipulation of facts, supplemental stipulation of facts, together with the exhibits attached thereto, are incorporated herein by this reference.

Petitioners Peter M. Coates, Charles N. Coates, Pamela L. Coates, and Cathy A. Coates are brothers and sisters who filed their individual income tax returns for 1965 with the district director at Tacoma, Wash. They were residents of Bellevue, Wash., at the time they filed their petitions herein.

Petitioner Rose Ann Coates Trust, Robert N. Coates, trustee, is a trust created under the laws of the State of Washington. Robert N. Coates, trustee, caused the trust to file its Federal fiduciary income tax return for 1965 with the district director at Tacoma, Wash. Robert N. Coates, trustee, resided in Bellevue, Wash., at the time the trust filed its petition herein.

Petitioner Trust Under Will of Sydney N. Coates, Robert N. Coates, trustee, is a trust existing under the laws of the State of Washington. Robert N. Coates, trustee, caused the trust to file its Federal fiduciary income tax return for 1965 with the district director at Tacoma, Wash. Robert N. Coates, trustee, resided in Bellevue, Wash., at the time the trust filed its petition herein.

Sydney N. Coates and Rose Ann Coates were husband and wife. Sydney N. Coates died on January 31, 1963. Rose Ann Coates is still living. Robert N. Coates, Ruby Boyd, and Molly Heinen are the children of Sydney N. Coates and Rose Ann Coates.

Robert N. Coates is the husband of Marjorie Coates. Peter Coates, Cathy Coates, Pamela Coates, and Charles N. Coates are their children.

Ruby Boyd is the wife of Morgan Boyd. Robert M. Boyd, Jr., and James Boyd are their children.

Molly Heinen is the wife of A. C. Heinen. Barbara Heinen, Gary Heinen, and Richard Heinen are their children.

A-12

CAM Industries, Inc. (hereinafter sometimes called CAM), began its existence as the sole proprietorship of Sydney Coates, doing business as the Coates Electric Manufacturing Co. Coates Electric manufactured a line of commercial and industrial electric equipment including ovens and water-heating equipment for government and private customers. The company was incorporated on June 1, 1948, and on May 18, 1965, changed its name to CAM Industries, Inc.

At the time of Coates Electric's incorporation in 1948 Sydney Coates received 696 shares of stock and Robert N. Coates, R. Morgan Boyd, Arthur C. Heinen, and Zena M. Gilbert received 1 share each. Subsequently the number of shares issued to Sydney Coates was reduced from 696 to 426 since the original allotment should have been 426 shares.

On May 31, 1960, Coates Electric amended its articles of incorporation as follows:

The capital stock of the corporation shall be 2,500 shares of Class A voting common stock at a par value of $30.00 per share and 7,500 shares of Class B non-voting common stock at a par value of $30.00 per share. Class A and Class B shareholders shall have identical and equal rights to dividends or to any other incidents arising from the ownership of said stock except that only Class A voting common stock shareholders shall be entitled to vote.

Shareholders were required to surrender their old shares:

For each ten shares delivered to the corporation each shareholder shall receive twenty-five shares of non-voting stocks together with 8⅓ shares of voting common stock.

On October 13, 1960, the shares of Coates Electric were held as follows:

	Class A	*Class B*
Sydney N. Coates	1,610	4,830
Robert N. Coates	710	2,130
R. Morgan Boyd	10	30
Ruby Boyd	50	150
Arthur C. Heinen	10	30
Molly Heinen	50	150
Treasury shares	10	30
Total	2,450	7,350

The single share of the original stock issued to Zena M. Gilbert had been purchased from her on August 23, 1960. The shares held by the children of Sydney Coates and their spouses were received by them as gifts from Sydney and Rose Ann Coates. Sydney and Rose Ann Coates made additional gifts of stock on October 13, 1960, January 2, 1961, and January 10, 1962, so that by May 20, 1965, prior the acquisition by CAM of all the stock of Washington Industrial Products, Inc. (hereinafter sometimes called WIP), the stock of CAM was held as follows:

	Class A	Class B
Estate of Sydney Coates		664
Robert N. Coates	1,640	2,250
Peter Coates		205
Cathy Coates		205
Pamela Coates		205
Charles N. Coates		205
Marjorie Coates		290
R. Morgan Boyd	10	422
Robert M. Boyd, Jr.		391
James Boyd		391
Ruby Boyd	390	372
A. C. Heinen	10	375
Barbara Heinen		340
Gary Heinen		340
Molly Heinen	390	325
Richard Heinen		340
Treasury shares	10	30
Total	2,450	7,350

WIP was incorporated on August 2, 1951, for the purpose of purchasing the assets of the Western Bakery Supply Co., Inc., which was doing business as the J. A. Campbell Co. The officers of Coates Electric had intended to purchase a large piece of machinery from the Campbell Co. Finding the Campbell Co. in financial difficulty and near default on its government contracts, the officers of Coates Electric organized WIP to take over the assets and contracts of Campbell. At that time Campbell manufactured ovens for the food industry (dissimilar to Coates Electric ovens) and an industrial oven.

The original incorporators of WIP, Sydney Coates, Robert Coates, Arthur Heinen, and Morgan Boyd, each received 75 shares of stock. Each received a salary from WIP, from which each deducted amounts sufficient to pay off the bank note covering the purchase of the Campbell assets.

On May 20, 1965 prior to the acquisition by CAM of all the stock of WIP all the stock of WIP and all the stock

of CAM were held as follows:

	Washington Industrial Products	CAM Industries	
		Cass A voting	Class B nonvoting
Estate of Sydney Coates....	75	.....	664
Robert N. Coates.....	51	1,640	2,250
Peter Coates	6	.....	205
Cathy Coates	6	.....	205
Pamela Coates	6	.....	205
Charles N. Coates.....	6	.....	205
Marjorie Coates (Mrs. Robt.)	.....	.....	290
R. Morgan Boyd.....	63	10	422
Robert M. Boyd, Jr.....	6	.....	391
James Boyd	6	.....	391
Ruby Boyd (Mrs. R. M.)...	.....	390	372
A. C. Heinen.....	57	10	375
Barbara Heinen	6	.....	340
Gary Heinen	6	.....	340
Richard Heinen	6	.....	340
Molly Heinen (Mrs. A. C.)...	.....	390	325
Total.....	300	2,440	7,320

WIP and Coates Electric operated as separate corporate entities until 1965. Robert N. Coates managed Coates Electric, and succeeded his father as president in 1963. WIP was managed initially by the Campbell Co. manager, and then by Arthur Heinen from 1955 until 1965.

In 1951 the premises of WIP and Coates Electric were located a half mile apart. Soon WIP was moved to the Coates Electric plant, but operations remained physically distinct except for the sharing of some heavy equipment. In 1955 Coates Electric required more room, so WIP was relocated 6 miles away.

Under the management of Arthur Heinen, WIP began to compete with Coates Electric, particularly in the industrial oven area. The two corporations also began subcontracting work to one another. Coates Electric sold some products to WIP for resale.

During this period Robert N. Coates was generally familiar with the operations of WIP, and made himself and the resources of Coates Electric available to WIP. He did not preside over day-to-day operations of WIP.

In 1964 and 1965 WIP and Coates Electric discussed combining their businesses. They determined that by combining office personnel, salesmen, inventories, purchasing, and machinery, they would realize substantial economies.

Before his death, Sydney Coates had transferred most of the stock of CAM from his estate, and, in the process, left his only son, Robert N. Coates, in complete control of CAM. It was the wish of Sydney Coates to give Robert N. Coates control of two-thirds of the voting stock and 51 percent of the total stock of CAM. At his death Sydney Coates had accomplished his purpose.

In combining CAM and WIP, Robert N. Coates insisted that he should have two-thirds voting control and at least 51 percent of the ownership of the resulting entity. The only manner in which this could be accomplished was by having CAM purcase WIP. A merger would have reduced Robert N. Coates' interests below the amounts he insisted upon.

On May 20, 1965, CAM and the shareholders of WIP entered into agreements of the following form:

AGREEMENT FOR SALE OF STOCK

Agreement made this 20th day of May, 1965, by and between the undersigned "Seller" and CAM INDUSTRIES, INC., a corporation, hereinafter called the "Buyer."

Seller hereby sells to Buyer, and Buyer hereby purchases from Seller, ... shares of the common stock of Washington Industrial Products, Inc., a Washington corporation, at the price and on the terms and conditions herein set forth.

1. Purchase Price. The price to be paid by Buyer to Seller for said shares of common stock shall be $1,000.00 per share or an aggregate purchase price of .....

2. Delivery of Stock and Payment of Purchase Price.

(a) The certificate or certificates for the shares of common stock sold hereunder by Seller are herewith delivered to Buyer, duly endorsed for transfer to Buyer, and Buyer hereby acknowledges receipt of said certificate or certificates.

(b) The purchase price shall be paid ....., or more at Buyer's option, on or before May 31, 1966, and a like sum, or more at Buyer's option, on the 31st day of May of each year thereafter until the 31st day of May, 1975, at which time the entire unpaid balance of the purchase price shall be due and payable. Buyer shall pay interest on the diminishing balance of said purchase price at the rate of four percent per annum from the 1st day of June, 1965, which interest shall be deducted from each installment payment and the balance of each payment applied in reduction of principal.

3. Successors and Assigns. The provisions of this agreement shall inure to the benefit of and bind the successors and assigns of Buyer and the executors, administrators, heirs, successors and assigns of Seller.

IN WITNESS WHEREOF, the parties hereto have executed this agreement the day and year first above written.

CAM liquidated WIP on May 31, 1965. On May 30, 1965, the accumulated earnings and profits of CAM were $183,000.

The fair market value of the contracts between CAM and the shareholders of WIP as of May 20, 1965, were $600 per $1,000 face value.

Sydney N. Coates and Rose Ann Coates executed mutual wills. Sydney Coates' will gave the house, automobile, bank accounts, and personal effects to Rose Ann Coates, and the residue of his estate went to the Trust Under Will of Sydney N. Coates. Rose Ann Coates' will provided that, in the event Sydney N. Coates predeceased her, she agreed to convey by separate instrument her interest in any community property "to the Trustee or Trustees as named under the terms of the Trust created by the Will of Sydney N. Coates."

The Trust Under Will of Sydney Coates provided, in part, that:

The Trustee or successor Trustee or Trustees shall pay a sum of not less than $500.00 a month to the said ROSE ANN COATES to keep her and maintain her in the manner to which she is accustomed, and to raise the said amount as the Trustee in his discretion may see fit, for any reason whatsoever, such as for sickness or for travel, but not limited thereto, said monthly income to come out of the income of the property in Trust, or from the principal thereof, provided that the said ROSE ANN COATES may, by an instrument in writing, waive said monthly payments or take a lesser sum during business depressions or emergencies.

It further provided:

NINTH: In the event of the death of the said ROSE ANN COATES, then the Trustee or successor Trustee or Trustees is directed to distribute the remaining corpus of the estate as follows:

A. To ROBERT N. COATES, a percentage of the estate interest of the partnership assets of COATES & COATES, equivalent to the percentage needed to give the said ROBERT N. COATES fifty per cent (50%) of said partnership assets.

B. The remainder of the corpus shall be distributed to the children of SYDNEY N. COATES and ROSE ANN COATES, to-wit: ROBERT N. COATES, RUBY N. BOYD and MOLLY M. HEINEN, share and share alike.

By order of the Superior Court of the State of Washington for King County dated September 23, 1965, Robert N. Coates as trustee of the Trust Under Will of Sydney N. Coates received:

4. 332 shares common stock in CAM Industries, Inc.

• • • •

8. An undivided one-third interest in the contract dated May 20, 1965, for the sale of 75 shares of Washington Industrial Products common stock.

The Rose Ann Coates Trust, established by an agreement dated August 21, 1965, provided:

ARTICLE II

Distribution from the Trust Estate

In that certain trust established under the Will of Sydney N. Coates, it is provided that:

"The Trustee or successor Trustee or Trustees shall pay a sum of not less than $500.00 a month to the said ROSE ANN COATES to keep her and maintain her in the manner to which she is accustomed, and to raise said amount as the Trustee in his discretion may see fit, for any reason whatsoever, such as for sickness or for travel, but not limited thereto, said monthly income to come out of the income of the property in Trust, or from the principal thereof, provided that said ROSE ANN COATES may, by an instrument in writing, waive said monthly payments or take a lesser sum during business depressions or emergencies;"

To the extent that the payments provided for Rose Ann Coates in the trust established under the Will of Sydney N. Coates are not made as provided therein, payment shall be made from the trust herein established, provided, however, that said payments hereunder shall in no event exceed $250.00 per month.

• • • •

ARTICLE V

Ultimate Distribution

Upon the death of Trustor, the Trustee or successor Trustee or Trustees are directed to distribute the remaining corpus of the trust to the children of SYDNEY N. COATES and ROSE ANN COATES, to-wit: ROBERT N. COATES, RUBY N. BOYD and MOLLY M. HEINEN, share and share alike.

On March 25, 1966, Robert N. Coates, as trustee of the Rose Ann Coates Trust, received by order of the Superior Court of the State of Washington for King County:

4. 332 shares common stock in CAM Industries, Inc.

• • • •

8. An undivided two-thirds interest in the contract dated May 20, 1965, for the sale of 75 shares of Washington Industrial Products common stock.

In his notice of deficiencies the respondent treated the "sale" of the WIP shares as a redemption by a related corporation within the scope of section 304.

On October 24, 1969, the Tax Court of the United States entered decisions of no deficiency in the following listed cases. With respect to the following listed stockholders of Washington Industrial Products, Inc., the respondent determined that the redemption of their stock in Washington Industrial Products, Inc., by Cam Industries, Inc., was substantially disproportionate pursuant to section 302(b)(2), I.R.C. 1954:

Name	*Docket No.*
Arthur C. Heinen & Molly M. Heinen	5873-68
Estate of Ruby M. Boyd, deceased, R. Morgan Boyd, executor	5811-68
R. Morgan Boyd	5812-68
Robert M. Boyd & Judith K. Boyd	5842-68
Gary A. Heinen	5861-68
Richard G. Heinen	5867-68
Barbara Gaye Heinen	5868-68
James E. Boyd	5869-68

OPINION

This case arises out of a transaction between the members of a family group and two corporations controlled by them. Sydney and Rose Ann Coates, together with their children, children's spouses, and grandchildren, owned all the shares of two corporations conducting related businesses. After the death of Sydney Coates, the family group agreed to combine the two corporations by having CAM "purchase" the shares of WIP.

Respondent's position is that the transaction was a redemption through the use of a related corporation, within the scope of section 304(a)(1).[3] Under sections 302(d)[4] and 301 (a) and (c),[5] respondent would treat the amount

3. SEC. 304. REDEMPTION THROUGH USE OF RELATED CORPORATIONS.

(a) TREATMENT OF CERTAIN STOCK PURCHASES.—

(1) ACQUISITION BY RELATED CORPORATION (OTHER THAN SUBSIDIARY).—For purposes of sections 302 and 303, if—

(A) one or more persons are in control of each of two corporations, and

(B) in return for property, one of the corporations acquires

of the distribution to the petitioners herein as dividends. Some members of the family group have escaped dividend treatment under section 302(b)(2). The case of Robert N. Coates and Marjorie Coates was not joined herein with these petitioners.

The trial of these related cases took place before the decision of the Supreme Court in *United States v. Davis*, 397 U.S. 301 (1970). Much of the proof, therefore, was directed at the issue of whether the transaction between the stockholders and their two corporations had a "business purpose" which might bring it within the scope of section 302(b)(1). Respondent's opening brief is devoted largely to this issue. However, because of several extensions of time for filing their brief, petitioners' opening brief was filed after the *Davis* case was decided. Consequently, the petitioners have shifted their primary position from the "business purpose" issue to another ground, namely, the question of proper parties. Respondent, in turn, was caught off balance in framing his reply. As a result, we are faced with briefs reflecting the turmoil of events. Moreover, both the parties and the Court are handicapped by the vagaries of a record created primarily for an issue which is now of uncertain status.

1. *Proper Parties.*—Petitioners' initial argument is that "the Rose Ann Coates Trust and the Trust Under Will of

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stock in the other corporation from the person (or persons) so in control.

then (unless paragraph (2) applies) such property shall be treated as a distribution in redemption of the stock of the corporation acquiring such stock. In any such case, the stock so acquired shall be treated as having been transferred by the person from whom acquired, and as having been received by the corporation acquiring it, as a contribution to the capital of such corporation.

4. SEC. 302. DISTRIBUTIONS IN REDEMPTION OF STOCK.

(d) REDEMPTIONS TREATED AS DISTRIBUTIONS OF PROPERTY.—Except as otherwise provided in this subchapter, if a corporation redeems its stock (within the meaning of section 317(b), and if subsection (a) of this section does not apply, such redemption shall be treated as a distribution of property to which section 301 applies.

5. SEC. 301. DISTRIBUTIONS OF PROPERTY.

(a) IN GENERAL.—Except as otherwise provided in this chapter, a distribution of property (as defined in section 317(a)) made by a

Sydney Coates did not transfer shares in Washington Industrial Products, Inc., to CAM Industries, Inc., and consequently are not chargeable with a dividend." Petitioners point out that the Rose Ann Coates Trust was created after the agreement to transfer the WIP shares. They argue that the agreement was made by the Estate of Sydney Coates, administering community property, and that the proper taxpayers are Rose Ann Coates and the Estate of Sydney Coates.

In its reply brief, respondent "agrees with petitioners that, if the [75 shares of WIP] stock of Sydney Coates was the community property of Sydney and Rose Ann Coates, then the transaction would be taxable one-half to Rose Ann Coates and one-half to the Estate of Sydney Coates. Rose Ann Coates is not a party to this action." Respondent's position with respect to the Estate of Sydney Coates is that the contract distributed to the testamentary trust would be deductible by the estate, and reported by the trust. However, respondent contends that "The argument that the stock of Sydney Coates was community property was never raised in the pleadings or in petitioners' opening statement."

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corporation to a shareholder with respect to its stock shall be treated in the manner provided in subsection (c).

• • • • • • • • •

(c) AMOUNT TAXABLE.—In the case of a distribution to which subsection (a) applies—

(1) AMOUNT CONSTITUTING DIVIDEND.—That portion of the distribution which is a dividend (as defined in section 316) shall be included in gross income.

(2) AMOUNT APPLIED AGAINST BASIS.—That portion of the distribution which is not a dividend shall be applied against and reduce the adjusted basis of the stock.

(3) AMOUNT IN EXCESS OF BASIS.—

(A) IN GENERAL.—Except as provided in subparagraph (B), that portion of the distribution which is not a dividend, to the extent that it exceeds the adjusted basis of the stock, shall be treated as gain from the sale or exchange of property.

(B) DISTRIBUTIONS OUT OF INCREASE IN VALUE ACCRUED BEFORE MARCH 1, 1913.—That portion of the distribution which is not a dividend, to the extent that it exceeds the adjusted basis of the stock and to the extent that it is out of increase in value before March 1, 1913, shall be exempt from tax.

Paragraph 5(f) of the petition alleges:

> Washington Industrial Products, Inc., is a Washington corporation incorporated on August 2, 1951. As of March 19, 1953, its shares were held by the following families—75 shares each:
>
> Mr. and Mrs. Robert N. Coates
> Mr. and Mrs. Sydney N. Coates
> Mr. and Mrs. R. Morgan Boyd
> Mr. and Mrs. Arthur C. Heinen
>
> The assets for which said shares were issued were transferred from a pre-existing company, J. A. Campbell Co., which was not related to anyone in either company here. These assets were paid for by funds earned by each of the four males above.

In his answer respondent admitted only that WIP was a Washington corporation incorporated August 2, 1951, and denied the remaining allegations of paragraph 5(f).

We think the statement that the shares were held by husband and wife ("Mr. and Mrs.") in a community property State, the statement that the assets which bought the shares were paid for with the husband's earnings, together with respondent's denial, clearly place in issue the status of the shares as community property.

The evidence presented indicates that the 75 shares of WIP were held by Sydney and Rose Ann Coates as community property. The correspondence concerning their estate planning shows that virtually all of their property was held as community property. In particular, the WIP shares were paid for from Sydney's earnings. Usually, property "acquired after marriage by either husband or wife or both, is community property" in Washington. Wash. Rev. Code sec. 26.16.030. We note that by their mutual wills it was agreed that Rose Ann Coates would place her share of the community property into the Rose Ann Coates Trust. The contract for sale of the 75 shares of WIP was eventually distributed two-thirds to the Rose Ann Coates Trust and one-third to the Trust Under Will of Sydney N. Coates. The odd apportionment is explained by the Order Approving Final Account, Report and Decree of Distribution of the Superior Court, which provided that in dividing

the community property "any disproportionate allocation necessary shall be made in the respective ownership of the contract receivable for the sale of the Washington Industrial Products stock, as hereinafter set forth."

Having determined that the 75 shares of WIP were held as community property, we must examine respondent's position that the transaction is therefore taxable one-half to Rose Ann Coates, who is not a party. This concession in respondent's reply brief would compel us to the conclusion that Rose Ann Coates, and not the Rose Ann Coates Trust is the proper party as to half of the shares.[6] However, it appears to us that this concession is based upon an erroneous interpretation of law. The stipulation of a conclusion of law is not controlling. *Davis v. Commissioner*, 241 F.2d 701 (C.A. 7, 1957); *Ohio Clover Leaf Dairy Co.*, 8 B.T.A. 1249 (1927), aff'd. 34 F.2d 1022 (C.A. 6, 1929); cf. *Forbes v. Commissioner*, 82 F.2d 204 (C.A. 1, 1936). *A fortiori*, we may disregard respondent's concession on this point of law.

In offering his concession, respondent has assumed that if the shares were community property, then Rose Ann Coates owned one half of them at the time of the transaction. But respondent has overlooked the existence of the mutual wills. Rose Ann Coates had agreed that upon Sydney's death she would transfer her half of the community property into trust. In the State of Washington this agreement was specifically enforceable by the beneficiaries of the agreement (who were Rose Ann and her children). *In re Young's Estate*, 40 Wash.2d 582, 244 P.2d 1165 (1952); *Cummings v. Sherman*, 16 Wash.2d 88, 132 P.2d 998 (1943); *Allen v. Dillard*, 15 Wash.2d 35, 129 P.2d 813 (1942). Therefore, upon Sydney's death and at the time of the transaction, the equitable owner of the 37½ shares was the Rose Ann Coates Trust.

Since the Rose Ann Coates Trust was the owner of 37½ shares at the time of the transaction, it is a proper party to this proceeding. In addition, the Rose Ann Coates Trust reported the income as capital gain on the installment basis on its tax return for 1965.

6. Nevertheless, the trust might be liable as a transferee.

We also conclude that the Trust Under Will of Sydney N. Coates is a proper party to this proceeding. Although the Estate of Sydney N. Coates sold the shares to produce the income, such income, when distributed, was deductible by the estate and taxable to the beneficiary. See secs. 661 and 662. The Trust Under Will of Sydney N. Coates recognized the pass-through character of the income distribution from the Estate of Sydney Coates and reported such income as capital gain on the installment basis on its tax return for 1965.

2. *Section 351.*—Petitioners contend that the sale of their WIP shares to CAM falls within the scope of section 351 as well as within section 304. Relying on *Commissioner v. Stickney,* 399 F.2d 828 (C.A. 6, 1968), affirming sub nom. *Henry McK. Haserot,* 46 T.C. 864 (1966), they argue that section 351 takes precedent over section 304, and that any recognized gain is taxable at capital gains rates.

We agree with respondent that section 351 is inapplicable to this transaction. Section 351 applies where "property is transferred to a corporation * * * by one or more persons solely in exchange for stock or securities in such corporation." Petitioners transferred their shares to a corporation for an agreement to pay an amount of cash plus interest in installments over a 10-year period. Petitioners do not contend that the agreement is a "security," and we think it is not. See *Warren H. Brown,* 27 T.C. 27 (1956). For the same reason, we think that petitioners did not do "exactly what Mr. Haserot did" in *Stickney.* In combining his businesses, Haserot received for his shares a cash credit *plus stock.* Thus, without considering whether section 351 or section 304 takes precedence when both apply, it is plain here that section 351 does not apply.

3. *Section 304.*—Petitioners next contend that section 304 does not apply to this situation. They refer to the language of section 304(a)(1)(A), which requires that "one or more persons are in control of each of two corporations." They argue that "one or more persons" refers to control by one person plus the attribution persons described in section 318.

This construction by the petitioners is contrary to section

1.304—2(b) and (c), Income Tax Regs., which refers to "two or more persons, in the aggregate" and gives examples of control by unrelated persons. Petitioners cite no authority for their interpretation. We are persuaded that the regulations present the proper construction of the statute. Section 304(c)(2) makes the attribution rules of section 318 expressly applicable for purposes of determining control. That being the case, the reference to "or more persons" in section 304(a)(1)(A) would, by petitioners' interpretation, become entirely superfluous.

Even if petitioners' interpretation of section 304(a)(1)(A) were correct, Rose Ann Coates, or Rose Ann Coates together with persons whose shares are attributable to her, had "control" of shares in excess of the 50 percent of the voting shares of each corporation. The shares of the estate and the shares of her children and grandchildren were all attributable to her. Sec. 318(a)(1)(A)(ii) and (a)(2). It is of no consequence that the shares of the children cannot be attributed to one another. Section 304 requires control by "one or more persons," not control by each and every person.

Accordingly, we hold that the sale of their stock by all the shareholders of WIP to CAM on May 20, 1965, was a redemption through the use of a related corporation under section 304(a)(1).

4. *Dividend Equivalence.* — Petitioners contend that there was a business purpose for the transaction, that the redemption was not pro rata, and that it meets the requirements of section 302(b)(1). To the contrary, respondent argues that the redemption of all the stock in WIP by CAM was essentially equivalent to a dividend to petitioners.

We might agree with the petitioners that there was a business purpose for combining WIP and CAM. Their business endeavors were to some extent overlapping, and could be managed more efficiently as a single enterprise. However, petitioners have presented no business justification for the particular manner by which they achieved this combination. We know that Sydney N. Coates and Robert N. Coates wanted Robert N. Coates to maintain a two-thirds voting interest and a 50-percent ownership in the

combined company, but there is no proof that this represented anything more than personal preferences. Had Robert N. Coates not insisted on maintaining personal control, the companies could have been merged without significant tax consequences.

It is not necessary in this case for us "to dissect the differences between corporate and shareholder business purpose which have so often troubled the courts." *Perry S. Lewis*, 47 T.C. 129, 135 (1966); *Estate of Moses L. Parshelsky*, 34 T.C. 946 (1960), revd. 303 F.2d 14 (C.A. 2, 1962). We are relieved of that burden by the recent decision of the Supreme Court of the United States that " 'the business purpose of a transaction is irrelevant in determining dividend equivalence' under § 302(b)(1)." *United States v. Davis*, 397 U.S. 301, 312 (1970). We do not understand petitioners to contend that a nonprorata redemption would by itself preclude dividend equivalence. Clearly section 302 reaches nonprorata redemptions. See sec. 1.302-2(b), Income Tax Regs.; cf. *United States v. Davis*, *supra* at 312.

Accordingly, we conclude that the distribution in redemption of petitioners' stock was essentially equivalent to a dividend.

5. *Fair Market Value of Contracts.*—In return for their stock in WIP, each shareholder received a contract from CAM obligating CAM to pay $1,000 per share of stock. This amount, plus interest of 4 percent on the unpaid balance, was payable in annual installments over 10 years. It is necessary to determine the fair market value of these contracts because under section 301(b)(1)(A) the amount of a distribution other than money is the "fair market value of the other property received." This question of value is factual.

At trial the parties called expert witnesses who offered their various opinions as to the value of the contracts. Their conclusions were:

		Per $1,000 face value
Mr. Morforde (1,000×.875×.65×.50)		$284.38
Mr. O'Farrell		847.00
Mr. Kleinberg	large contract—15 percent	618.80
	small contract—18 percent	554.10

Mr. O'Farrell demonstrated no particular familiarity with the type of contract involved here. Mr. Morforde approached it indirectly through his experience with first mortgages. And as an investment banker he was quite wary of unsecured contracts of this type. Mr. Kleinberg, as president of a discount corporation, impressed us as the witness who was most familiar with this type of contract, having dealt with "similar" unsecured contracts, both large and small. All witnesses agreed that the market for such contracts was limited.

Taking into account the testimony of the witnesses, and the financial information made available to us concerning CAM's ability to pay, we conclude that the fair market value of the contracts was $600 per $1,000 face value.

To reflect the conclusions reached herein,

Decisions will be entered under Rule 50.

APPENDIX C

Internal Revenue Code of 1954 (26 U.S.C.):

Sec. 301—DISTRIBUTIONS OF PROPERTY. (a) IN GENERAL.—Except as otherwise provided in this chapter, a distribution of property (as defined in section 317(a)) made by a corporation to a shareholder with respect to its stock shall be treated in the manner provided in subsection (c).

• • • •

(c) AMOUNT TAXABLE.—In the case of a distribution to which subsection (a) applies—

(1) AMOUNT CONSTITUTING DIVIDEND.—That portion of the distribution which is a dividend (as defined in section 316) shall be included in gross income.

• • • •

Sec. 302—DISTRIBUTIONS IN REDEMPTION OF STOCK.

• • • •

(d) REDEMPTIONS TREATED AS DISTRIBUTIONS OF PROPERTY.—Except as otherwise provided in this subchapter, if a corporation redeems its stock (within the meaning of section 317(b), and if subsection (a) of this section does not apply, such redemption shall be treated as a distribution of property to which section 301 applies.

• • • •

Sec. 304—REDEMPTION THROUGH USE OF RELATED CORPORATIONS. (a) TREATMENT OF CERTAIN STOCK PURCHASES.—

(1) ACQUISITION BY RELATED CORPORATION (OTHER THAN SUBSIDIARY).—For purposes of sections 302 and 303, if—

(A) one or more persons are in control of each of two corporations, and

(B) in return for property, one of the corporations acquires stock in the other corporation from the person (or persons) so in control,

then (unless paragraph (2) applies) such property shall be treated as a distribution in redemption of the stock of the corporation acquiring such stock. In any such case,

the stock so acquired shall be treated as having been transferred by the person from whom acquired, and as having been received by the corporation acquiring it, as a contribution to the capital of such corporation.

(2) ACQUISITION BY SUBSIDIARY. — For purposes of sections 302 and 303, if—

(A) In return for property, one corporation acquires from a shareholder of another corporation stock in such other corporation, and

(B) the issuing corporation controls the acquiring corporation, then such property shall be treated as a distribution in redemption of the stock of the issuing corporation.

(b) SPECIAL RULES FOR APPLICATION OF SUBSECTION (a).—

(1) RULE FOR DETERMINATION UNDER SECTION 302(b). —In the case of any acquisition of stock to which subsection (a) of this section applies, determinations as to whether the acquisition is, by reason of section 302(b), to be treated as a distribution in part or full payment in exchange for the stock shall be made by reference to the stock of the issuing corporation. In applying section 318(a) (relating to constructive ownership of stock) with respect to section 302(b) for purposes of this paragraph, sections 318(a)(2)(C) and 318(a)(3)(C) shall be applied without regard to the 50 percent limitation contained therein.

(2) AMOUNT CONSTITUTING DIVIDEND.—

(A) WHERE SUBSECTION (a)(1) APPLIES.—In the case of any acquisition of stock to which paragraph (1) (and not paragraph (2)) of subsection (a) of this section applies, the determination of the amount which is a dividend shall be made solely by reference to the earnings and profits of the acquiring corporation.

(B) WHERE SUBSECTION (a)(2) APPLIES.—In the case of any acquisition of stock to which subsection (a)(2) of this section applies, the determination of the amount which is a dividend shall be made as if the property were distributed by the acquiring

corporation and immediately thereafter distributed by the issuing corporation.

(c) CONTROL.—

(1) IN GENERAL.—For purposes of this section, control means the ownership of stock possessing at least 50 percent of the total combined voting power of all classes of stock entitled to vote, or at least 50 percent of the total value of shares of all classes of stock. If a person (or persons) is in control (within the meaning of the preceding sentence) of a corporation which in turn owns at least 50 percent of the total combined voting power of all stock entitled to vote of another corporation, or owns at least 50 percent of the total value of the shares of all classes of stock of another corporation, then such person (or persons) shall be treated as in control of such other corporation.

(2) CONSTRUCTIVE OWNERSHIP. — Section 318(a) (relating to the constructive ownership of stock) shall apply for purposes of determining control under paragraph (1). For purposes of the preceding sentence, sections 318(a)(2)(C) and 318(a)(3)(C) shall be applied without regard to the 50 percent limitation contained therein.

Sec. 351 — TRANSFER TO CORPORATION CONTROLLED BY TRANSFEROR. (a) GENERAL RULE.—No gain or loss shall be recognized im property is transferred to a corporation (including, in the case of transfers made on or before June 30, 1967, an investment company) by one or more persons solely in exchange for stock or securities in such corporation and immediately after the exchange such person or persons are in control (as defined in section 368 (c)) of the corporation. For purposes of this section, stock or securities issued for services shall not be considered as issued in return for property.

(b) RECEIPT OF PROPERTY.—If subsection (a) would apply to an exchange but for the fact that there is received, in addition to the stock or securities permitted to be received under subsection (a), other property or money, then—

(1) gain (if any) to such recipient shall be recognized, but not in excess of—

(A) the amount of money received, plus

(B) the fair market value of such other property received; and

(2) no loss to such recipient shall be recognized.

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